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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 002945

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S/EEE MORNINGSTAR

DOE FOR HEGBURG, EKIMOFF

DOC FOR JBROUGH

NSC FOR MMCFAUL

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TAGS: EPET ENRG ECON EINV PREL RS

SUBJECT: YUKOS DECISION COULD BE MAJOR IRRITANT FOR YEARS

Classified By: Ambassador John R. Beyrle for Reasons 1.4 (b/d)

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YUKOS CASE TO DRAG ON FOR YEARS  
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¶11. (SBU) The November 30 decision by a tribunal of the Permanent Court of Arbitration in the Hague that Russia is bound by the Energy Charter Treaty (ECT) was a major blow to the GOR. According to representatives of the plaintiffs in the case, led by former Yukos shareholders now known as GML Limited, the tribunal decided Russia, which had signed but not ratified the ECT, must abide by the investment protection provisions of the treaty. Furthermore, the tribunal decided that the plaintiffs were entitled to those protections. The ruling thus paves the way for the plaintiffs to pursue a suit against the GOR based on their claim that the dismantling of Yukos, then Russia's largest oil company, amounted to expropriation. The plaintiffs have said they could be entitled to compensation in the range of \$100 billion if they win, and that they could ultimately attach GOR assets abroad if Russia refuses to pay damages. The GOR has thus far refused to comment on the decision.

¶12. (C) Several legal experts with whom we spoke about the case believed Russia would fight the case vigorously and that it could drag on for many years, likely much longer than the three years reported in various press articles. Furthermore these lawyers and other analysts, citing both precedent and the general propensity of the GOR, believed strongly that there would be little chance of Russia complying with a ruling involving multi-billion dollar damages. As some of our contacts pointed out, even if the plaintiffs ultimately win damages, the GOR would also likely fight every attempt to attach GOR assets abroad. PM Putin's views on the matter were evident in his harsh attacks on Yukos and Khodorkovsky, its jailed former owner, during his December 3 annual question and answer session with the Russian public (septel).

One contact suggested that Putin's portrayal of Yukos as a criminal enterprise, and even Khodorkovsky's second trial, are partly designed to support Russia's defense in Yukos cases in international courts. Given Putin's direct interest in the issue, we expect Russia to offer no conciliation in the matter.

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WIDE-RANGING IMPLICATIONS  
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¶13. (C) This decision, while only the first step in a long

process, is significant. One lawyer with whom we spoke, noting the huge sums of money involved, called it the "legal equivalent of nuclear war." The ruling and the coming proceedings could have a major impact on the perception of Russia's investment climate for years to come. If the GOR ultimately wins the case, it could escape serious damage to its image. However, if the GOR loses and shrugs off the ruling, it will send a signal that investors in Russia cannot be certain of international protections related to their investments. Furthermore, the case (and any possible future ones) will constantly remind international investors of the perils of investing in Russia.

¶4. (C) The case could also have consequences for a broad range of entities beyond investors in Russia's energy sector.

If the case involved a few million dollars, or even several tens of millions of dollars, its broader impacts might be more limited. However, if damages are awarded anywhere near the scale suggested by the plaintiffs, the case could result in major legal and diplomatic headaches for any country in which Russia has assets. While some analysts have pointed out that Russia's assets abroad would never approach the sums claimed by the plaintiffs, the plaintiffs have raised the possibility of seizing (state-owned) Rosneft's oil shipments abroad, (state-owned) Gazprom's gas shipments, or (state-owned) Aeroflot's airplanes. Foreign governments could thus find themselves in the uncomfortable position of having to enforce their own courts' orders against what would surely be enormous political pressure applied by the GOR. While such scenarios wouldn't play out for several years, if ever, the case merits close scrutiny in the meantime.

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